CITY OF NEWPORT NEWS

OFFICE OF THE CITY MANAGER

March 26, 2013

TO: The Honorable City Council

FROM: City Manager

SUBJECT: Recommended FY 2014 Operating Budget

I am transmitting for your consideration, my recommended operating budget for the fiscal year that begins July 1, 2013 and ends June 30, 2014.

This memorandum summarizes my proposed Fiscal Year 2013-2014 operating budget for the City of Newport News. Like other recommended budgets in recent years, it attempts to reconcile community needs, organizational imperatives, and significant financial constraints. The details of the Recommended Budget are necessarily complex, as are the needs of this community. While many important initiatives, priority judgments, and more nuanced recommendations are included in the budget, the broad-brush factors shaping its main features are actually fairly straightforward.

Expenditure requirements are driven by five factors: a need to keep our salary structure for both the City and the Schools competitive for the long term, an obligation to bring our pension system into sustainable balance (now much more achievable because of additional reforms recently approved), a need to restore funding for various ongoing operations that were cut back during the recession but will grow more costly to restore if we wait further (paving, equipment, technology), regional and contractual obligations (Hampton Roads Transit (HRT), Hampton Roads Regional Jail (HRRJ), animal services), and the direct and indirect impact of State and Federal regulatory mandates (sewer, stormwater, and water).

On the cost control side of the budget, most of the strategies that we have successfully deployed in recent budgets such as hiring lag, position elimination, overhead trimming, and short-term reductions, are no longer available options for further cutting. While some additional efficiencies and consolidations are included in the budget recommendation, it is my judgment that our citizens and City Council would prefer to pay for the services they expect than to eliminate things where most of the money is spent.

OVERVIEW

I am submitting to you a budget that addresses the community's needs on several differing levels. First, the proposed budget maintains the basic services that citizens expect of the City of Newport News. Essential expenditure increases were made to limit service reductions or to maintain contractual agreements at the same level in the upcoming year that we are presently receiving. Second, only two direct public services will be eliminated, and by this action, many current efficiencies and future program options are achieved. Third, in the proposed budget we must complete funding the Denbigh Community Center and the 311 Customer Contact Center, consistent with our Strategic Priorities. Fourth, this recommended budget also provides for additional internal efficiencies; while not obvious to the citizen, in several areas we will be fundamentally altering some tools we use to provide services. Fifth, to avoid greater long-term expenses, I am partially restoring essential infrastructure investments and equipment funding that were reduced during the recession. While the economy is still in somewhat fragile stages of recovery, we are to the point where if underfunding is continued in residential street paving, information technology equipment, and operational vehicles, the impact of restoration of funding beyond FY 2014 will be significant. Unless initial steps are taken now to refurbish monies incrementally for these functions to plan for the future and to be ready to move the City when the economic recovery is more robust, we will find ourselves in a position in the future of diverting a considerable percentage of the operating budget to essential tools. And finally, to the extent possible given our constraints, the Recommended Budget invests in City Council Strategic Priorities.

My total recommended FY 2014 budget is $782,010,315, which is an increase of $34,770,265 or 4.6% higher than the adopted current fiscal year. This total budget amount includes the General Fund, Schools, Public Utilities, and all Special Revenue and Trust Funds. In a change from past practices, it is anticipated that the School Fund will experience approximately $2.5 million more in revenue from the Commonwealth for operations; that Fund will be higher in the upcoming fiscal year. Public Utilities (Waterworks) will again experience reduced water demand and has proposed a budget that continues the policy started in FY 2012 of moving that Fund's revenue base from being dependent on the volume of water used to fees that are fixed more to service delivery costs. Due to the uncertainty of sequestration impact at this time, we have no information on the final determination on the amount of Federal funds that the City receives in support of the Community Development Block Grant (CDBG). For this reason, we are anticipating a funding level equal to FY 2013, until more information is available.

Of this total budget amount, the FY 2014 Recommended General Fund Operating Budget totals $432,973,000, which is an increase of $18,452,000 or 4.5% higher than the adopted FY 2013 Operating Budget. This increase allows us to meet our contractual obligations, sustain most services, and covers many costs beyond our control while meeting Pension commitments and providing a small employee salary adjustment.

Yet again, our largest revenue source, Real Estate Taxes, is projected to decline in FY 2014. As you know, current Real Estate Taxes are generated from real estate values. Real estate property assessments, which are based on market values established for the 12-month period of January 1, 2012 to December 31, 2012 (calendar year 2012), are expected to decrease for the fourth consecutive fiscal year. It is disappointing that the City will be experiencing yet another year of revenue loss from this major source at this stage of the national economic recovery. The chart below illustrates the dramatic change in values, with the anticipated Real Estate Levy on July 1, 2013 to be less than that of FY 2008. In other words, we will be generally collecting $3.5 million less Real Estate revenue than we did six years ago, at the same tax rate of $1.10 per $100 of assessed value, even <u>after</u> the expanded major projects that have occurred over that same time period (Canon, the Shipyard, Riverside, various other retail and high volume residential projects, just to name a few).

Recent History of Real Estate Assessment Values (Adopted Budget)

An average assessment decrease of approximately (2.75%) will be seen, with most residential property owners paying real estate taxes on a lower valued property than in FY 2013. To put this in perspective, this percentage decline in assessments equates to a $3 million loss or (1.6%) less from the City's single largest revenue stream just between FY 2013 and FY 2014 at the same tax rate. Commercial and Industrial properties will be fairly stable.

For the past five years, due to the impact of falling revenue sources and proportionate expenditure reductions, the General Fund Operating Budget has declined from $433 million to $414 million. In order to manage daily operations of public safety and corrections, contributions to public education, essential public works operations, pay outstanding debt obligations, provide the human services safety net programs, as well as offer quality-of-life options to our citizens, we have now cut costs and operations to the point where the choice is either to eliminate services or increase the real estate tax rate. I am proposing a twelve cents (12) increase on the Real Estate Tax rate, from $1.10 per $100 of assessed valuation to $1.22.

The History of General Fund Real Estate Tax Revenue

The ongoing assessed value decline reinforces the decision made in FY 2012 to shift our tax abatement program to a tax deferral for our elderly and disabled citizens. Prior to this change, the cost of the tax abatement program had grown to five times its size from 20 years ago. In FY 2012, tax relief represented close to a $3 million loss in revenue to the City, exclusive of the impact of the loss of $475,000 in additional real estate revenue from the recently mandated tax relief for Disabled Veterans. Without a change to the tax abatement program, the City would lose substantial and increasing amounts of Real Estate Tax revenue over time. The decision to change to a tax deferral program was responsible, fair to all the citizens as users of City services, and forward-looking. As a result of this action, our loss of revenue from the tax deferral program is anticipated to decline from $3.3 million in FY 2011 to $1.7 million in FY 2014. Over time, this revenue loss will be completely eliminated, while the substantial benefit through deferral is maintained for most impacted individuals. As the State-mandated tax relief for Disabled Veterans becomes better known, the City's liability has increased. For FY 2014, this highly specific tax relief will increase by $175,000 to an anticipated $650,000.

As you know, the State's payment to localities declined for five consecutive years, which does not include overall under-reimbursement for State programs as has been the pattern for many years. During this time period, the City has lost a cumulative $7.9 million in direct State Aid to Localities. As the City absorbed these expenditures within its base budget, the State experienced surpluses in its operating budget. Recognizing the burden continued State funding reductions would have on the localities, the Governor's revised FY 2014 Budget did recommend "restoration" of State funding to select activities. And to be clear, restoration meant that an additional reduction to the localities planned in FY 2014 would not occur. In other words, FY 2014 State funding would be at the same reduced FY 2013 level, and not result in new cuts.

Other General Fund revenues for FY 2014 have been estimated based on a continued slow economic recovery. Locally generated Machinery and Tools and Personal Property Taxes are showing moderate change, with increases of $900,000 in each over the current fiscal year. Sales Tax revenue remains on target for collections in the current year. Forecasting limited new retail development within the City for the full year in FY 2014, an additional $857,000 in sales tax revenue, or 4% growth, has been added. Meal Taxes are estimated to increase by $1 million.

So as to not be overly reliant on higher real estate tax rates, adjustments in locally controlled rates of Lodging Tax and Amusement/Admission taxes are being proposed. These particular rates are recommended for increase as they are specific taxes that are based on a personal choice and are in part paid by non-Newport News residents.

For the Lodging Tax, I am recommending that the rate increase from 7.5% to 8.0%. This half of one percent (0.5%) rate increase is anticipated to generate approximately $215,000 in additional revenue. Also, I am recommending that a new, flat $1 per day charge be imposed, with estimated revenue of $650,000. The revenue generated from this tax would be dedicated to a new Cultural Attractions Fund. In response to the growing financial needs within the arts and museum community for both public and private facilities, I have proposed creating a funding mechanism dedicated to community cultural activities beginning in FY 2014. The proceeds from the new portion of the Lodging Tax would be made available to such organizations through an application process, for those groups in need of additional financial support, with the first $400,000 dedicated to operations of the Virginia Living Museum (VLM). Both City and private agencies that may be in need of operating or capital support may then compete for those funds. The existing formula for lodging taxes being shared with the Tourism Fund would be maintained with the exception that the new rate increment would support the proposed Cultural Attractions fund.

The Amusement Tax is recommended to increase from 7.5% to 10.0%, with an additional $159,000 estimated to come from this change.

The chart below shows the loss of the Real Estate Tax revenue and new revenue generated by the proposed rate increases.

FY 2014 Proposed Rate and Fee Changes

(in Millions)

Revenue	FY 2013 Adopted	FY 2014 Estimate	Difference Amount
Real Estate Tax @ current Rate	$151.4	$148.5	($2.9)
Real Estate Tax @ proposed Rate	$0	$16.0	$16.0
Lodging Tax Increment	$3.100	$3.965	$865K
Amusement Tax (2.5%rate increase)	$465K	$624K	$159K
Total	**$155.0**	**$169.1**	**$14.1**

EXPENDITURE CHANGES

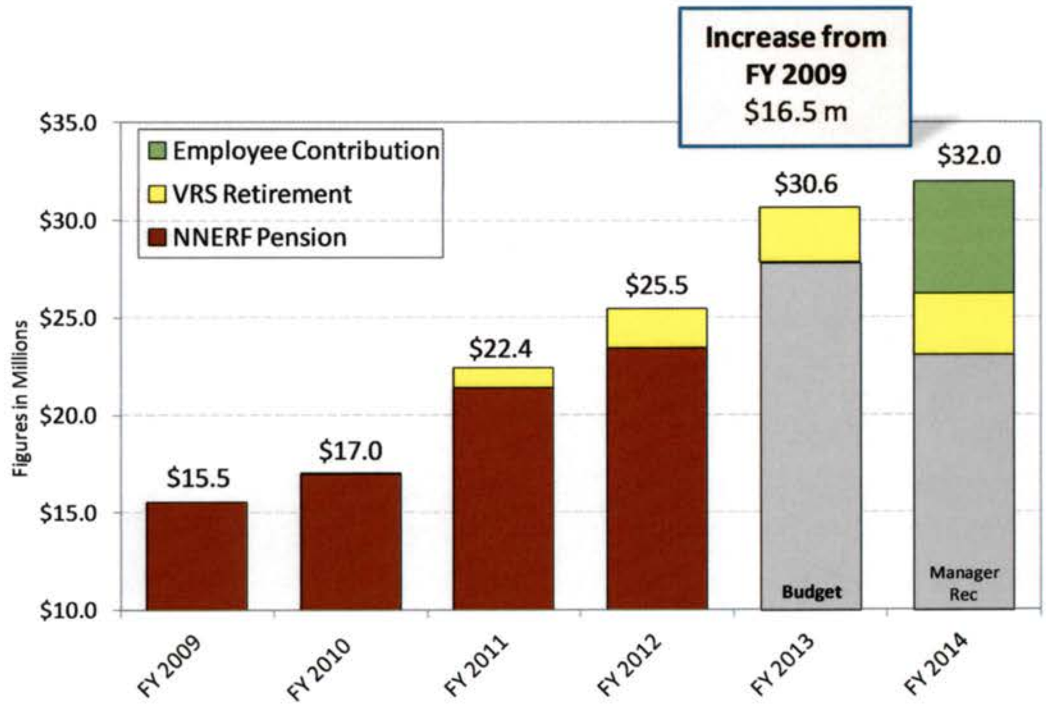
In September 2012, after identifying the known expenditure drivers for the upcoming budget, I instructed my Management Team to review all of their departmental operations and provide me with intelligent, practical, and sustainable reductions that would once again focus on core functions, increase efficiency by reducing or eliminating non-essential operations, and/or reorganize staffing to accommodate the highest priority of those core services. The target reduction for all departments was initially five (5) percent. To achieve this magnitude of cuts without a revenue increase from taxes and fees, there would have had to be sustained reductions and program eliminations that could only be categorized as untenable. Given several years of cost cutting, not surprisingly, most of the significant cuts that I reviewed involved curtailing services that I believe City Council and citizens would oppose. As you know, since FY 2009, operational expenses have been reduced substantially. Reductions and other changes are summarized in the Recommended Budget document under the blue tab labeled *Expenditures*.

There are six general areas where this recommended budget reflects increased spending or funding of a new initiative. These areas include pension contributions, health care premiums, the City's contribution to the School Division, full-year operation of the Denbigh Community Center and 311 Customer Contact Center, an employee salary adjustment, and restoration of basic operational funding (paving, Cash Capital contribution, vehicle and technology replacement equipment).

Pension Contributions

We remain committed to an eight-year plan to incrementally increase the City's contribution to the Annual Required Contribution (ARC) to the Pension Fund. FY 2014 will be the fifth year in this process. This is a fundamental expense of our operating budget; the recommended budget brings the ARC up to 73% from 65%. The annual sustainable contribution to the pension system is $23.1 million City-wide, with $5.7 million in additional funding from the 5% salary contribution of all NNERF employees. This recommended amount is consistent with our plan to completely restore the actuarial position of our pension fund over time, and is achievable due to the City Council adopted changes to the Pension system in October 2012. While these changes lowered the overall ARC dollar requirement from $56 million to $41 million over the planned eight-year period, we choose to maintain the scheduled percentage rate increase at the same level originally planned, rather than have the FY 2014 annual contribution equal to the FY 2013 level of $28.9 million in addition to employee contributions. The choice of remaining on the planned percentage increase of the ARC allowed us to divert some of the funds that would have otherwise gone to the Pension contribution to other priorities. It is important to recognize that the School Division is a separate but important participant in this pension funding process and has budgeted for the same percentage increase in the Superintendent's recommended budget at slightly more than $7 million for FY 2014.

History of City Pension Contributions City-wide



As a member of Virginia Retirement System (VRS), we fully fund the annual contribution for those employees hired or rehired after March 1, 2010 or who elected to shift from the City's pension system. As more of our workforce participates in VRS, so grows our annual contribution. This fact, plus the change in the VRS actuarial assumptions for the upcoming fiscal year, increased the General Fund payment by $372,326 from $2.1 million to $2.4 million. This annual VRS funding is in addition to the FY 2013 State mandate that required municipal employees of localities enrolled in VRS to pay a 5% contribution toward retirement. You will recall that this mandate also stipulated that those same employees receive a salary adjustment of 5% to offset the cost. As a separate State requirement, we must participate in a Line of Duty Act program that provides benefits to first responders who die or become disabled in the line of duty. The City has made the decision to be self-insured for this expense (versus participating in a VRS program), and thereby reduced the anticipated expense from $450,000 in FY 2013 to $250,000 in FY 2014.

As a point of reference, in FY 2013, a significant change occurred in the representation of retirement costs for City employees in the budget. The annual pension cost is a fundamental expense, whether through the City's independent pension program or through VRS. For that reason, all costs associated with retirement have been moved from the individual departments of the General Fund and consolidated in the Nondepartmental cost center. (Retirement expense funding for all Special Revenue and Trust Funds remains in those Funds). This shift of expense allows for increased transparency as to the total cost of retirement expenses, an easier year-to-year comparison moving forward and better fiscal control.

Health Care Costs

Health care costs continue to rise, with an insurance increase anticipated in FY 2014 of 5% beginning in December 2013. The annual increase is generally based on the prior-year claims and services provided to our employees. The resulting impact to the General Fund is a health care cost increase approaching $1.5 million, with an additional cost increase of over $336,000 spread across the other operating funds in FY 2014. Without the benefit of eliminated positions contained in this recommended budget, the amount would have been higher. This benefit continues to be an important factor for our employees, as part of our overall compensation package, as other employers have targeted this benefit as cost savings by reducing their contribution to this cost. For the City, particularly our family health insurance benefit, it remains a strong recruiting tool and acts as additional leverage for soliciting qualified candidates when all other aspects of employment are equalized between the localities.

While a critical element for employee compensation, increases in health insurance premiums have unfortunately become an annual budget challenge for the City. Careful plan management and lower experience costs are the keys to keeping the premium increase responsibility low, but these two aspects have their limits and will only contain costs but so far. Therefore, during the current fiscal year, we took actions to break from the same health insurance decision-making parameters as in the past, as we could not continue to experience premium increases absorbing a larger share of our revenues each year.

A multi-pronged approach has been developed to attempt to curb the growth in this annual expense. As a first step to reducing long-term health care costs, we changed the traditional premium rate payment from the ratio of 75% City/25% employee contribution toward the total premium cost, to a set dollar value the City would contribute during the fiscal year. The next step was in FY 2013, the City began offering three choices (instead of one) for Health Insurance policies: the traditional

Preferred Provider Organization (PPO) plan, a HMO-Point of Service plan, and a high deductible plan. With each plan option, the individual is able to choose the coverage that best suits their needs, while the City and the employee both are managing their health care dollars in less expensive and less robust plans, and thereby encouraging employees to take a more active role in reducing their annual costs over time. To approach the long-term overall health care costs, the City intends to establish a formal, defined Wellness Program with initial funding for this program included in the Recommended Budget at $100,000.

Fuel Prices

Fluctuating fuel costs make it difficult to determine a year-long average of per-gallon costs. Vehicle fuel is an important part of our operations, supporting public safety functions, public works activities, and human services programs, among others. Our annual consumption remains stable at nearly 1.2 million gallons. For FY 2014, fuel prices are predicted to remain level with FY 2013. For the current fiscal year budget development, in March 2012 fuel prices were on the rise, and thus were budgeted at what was believed to be the appropriate level for FY 2013. While the price of fuel was high during the first months of this fiscal year, costs have declined again and have remained slightly lower than were originally projected for the average for the fiscal year. The FY 2014 Recommended Budget assumes an average fuel purchase price of $3.25 per gallon, which is a decrease from the FY 2013, budgeted per gallon rate of $3.60. The resulting FY 2014 impact to the General Fund is a fuel cost decrease of ($167,462). This remains a sensitive expense and if fuel prices trend upward, we may need to change the rate forecast for vehicle fuel closer to the final budget reconciliation for FY 2014.

Contribution to Schools

Local support for public education remains a critical component in the budget. I am recommending a contribution of $115,300,000, which provides an increase of $1.9 million; 1.7% higher than the current fiscal year. This amount includes $12.4 million in City funding for Schools debt service.

The City has increased funding to Newport News Public Schools (NNPS) for the past three fiscal years, signaling our commitment to public education. In a time when the State has made massive reductions in its support to Schools (from $194.8 million in FY 2009 to a low of $158.4 million in FY 2012), Schools too have been faced with higher pension contributions, as well as funding the State-proposed teacher salary adjustment of 2%, effective July 1, 2013, (with an additional 1.5% salary adjustment to reach the State-mandated 5% employee contribution to VRS). While the State's FY 2014 budget proposes to restore funding from the Commonwealth back up to the $163.8 million level, this additional contribution from the City of $1.9 million will help to lessen the gap due to the elimination of Federal stimulus funds and impact of the other pressures on the Newport News Public Schools' budget. From a broader City perspective, this additional contribution to Schools aids in teacher recruitment and retention by assisting NNPS' proposed salary increase.

Employee Compensation and Benefits

The recommended operating budget includes funding for a general wage increase for eligible City employees of 2%, effective July 1, 2013. The cost of this salary adjustment in the General Fund is $2.5 million and $3.3 million City-wide. The percentage increase equals what the State is proposing for a base increase for teachers and for other State employees, and does allow for a full fiscal year salary adjustment. I believe most localities in Hampton Roads are proposing a similar increase.

Full-Year and Restoration Funding, New Initiatives

The operation of the 311 Customer Contact Center, anticipated to begin operations in late FY 2013, will be fully funded in the upcoming fiscal year. Directly supporting our Fiscal Management and Efficient Operations Strategic Priority, this function will change the way that we communicate with our customers as a City, with the 311 Customer Contact Center providing a "one-stop-shop" to answer questions and receive citizen concerns and issues. The FY 2013 Budget includes $332,508 for this operation, funding for six full-time positions and part-time staff. Full-year functionality in FY 2014 is proposed at $455,356; the 311 Customer Contact Center will include ten full-time positions (One Communications Manager, One Communications Supervisor, one Configuration Analyst position, and seven Customer Service Assistants, two of these positions being new allotments and partially funded in FY 2014), as well as part-time staff. The remaining funds will be used for overall operating expenses such as Contractual Services, Telecommunications, and Supplies.

Beginning on July 1, 2013, the City and surrounding localities will no longer use the SPCA facility for animal sheltering services. Currently, a new 29,000+ square-foot animal shelter is being built in the City. Based on the construction completion date, operating costs to open and run the animal shelter for 11 months, including salaries, land rent, capital reserve, and certain other costs will be prorated to the participating localities. (Debt Service will be paid in the full amount and needs to be paid regardless of opening in FY 2014). The localities' shares of operations are Newport News 47.21%, Hampton 35.86%, Poquoson 3.19%, and York County 13.77%. Potential revenue from adoption fees, spay/neuter charges, and micro-chipping would go to offsetting the localities' costs for operations and debt service. The City's prorated portion of the new Peninsula Regional Animal Shelter operating costs is $395,872, with the City's share of debt service at $300,199, for a combined cost of $696,071. At the same time, and while the new facility is under construction, the City will continue to use the SPCA sheltering facilities on a month-to-month basis. Included in the proposed FY 2014 budget is an anticipated six months of payments to the SPCA at the current rate, to allow for flexibility in the opening of the new Regional Shelter. This represents ($236,999) in savings for the remainder of FY 2014 that offsets the cost of the new facility operations.

The Tourism Zone Benefit of $1,271,983 is based on a State program that allows for new businesses in the City's designated Tourism Zones to receive back, under specific conditions, a percentage of new sales, and food and beverage taxes generated during an agreed-to timeframe. Based on new businesses open or soon to be operating in these Zones, there is the potential for these funds to be reimbursed to the vendor. The offsetting new revenue created by these businesses is estimated in Sales Tax and Meals Tax for FY 2014.

In FY 2014, a new component will be created in the General Fund's Nondepartmental section to provide additional program funding for Strategic Priorities of the City. The priorities include Economic Development and Redevelopment, Environmentally Sustainable Local Government Policies, Community Renewal and Maintenance, Fiscal Management and Efficient Operations, and Maximum Emphasis on Public Safety.

For the Economic Development priority, funding in FY 2014 in the amount of $650,000 is for a new Cultural Attractions fund, which will be supported by the proposed Lodging Tax change. The purpose of this new Fund is to be a resource for both public and private museums and cultural centers to solicit the City for additional capital and operational support during the fiscal year. Funding of $152,500 for grass cutting and litter removal for vacant and City-owned lots and other visually critical projects will be for the City's Community Maintenance initiatives. These funds also include additional money for three (3) new areas of landscaping (the Grissom Municipal Annex, Denbigh Community Center, and the sound wall at Jefferson Avenue at J. Clyde Morris Boulevard). Initial funding for the emerging Youth, Gang, and Gun Violence Reduction program is budgeted at $1,100,000.

The City has a current vehicle and heavy equipment fleet of over 1,500 items, with a replacement value of $87 million. Adequately funding this expense has been a challenge at best, and in addition to annual budgetary funds, we have depended on prior year surpluses to meet funding requirements for the replacement of this fleet. In order to meet our reduced revenues, we have stretched the life span of the vehicles to the point that repair and maintenance are becoming more costly than actual replacement of our rolling stock. To compensate for underfunding and to the replace equipment that is actually scheduled to reach its maximum performance levels in FY 2014, the funding level would need to be $5.9 million in the General Fund alone. The sustained annual General Fund replacement level should be $3.2 million. Instead, we have only managed during this recession to afford $750,000 in the General Fund. For next fiscal year, I am recommending a total of $1 million for vehicle replacement in the General Fund, which is a $250,000 increase. These monies, along with the proceeds from the sale of surplus vehicles will bring us closer to our goal of restoring adequate funds for annual vehicle replacement.

Much like vehicle replacement, the City historically has not budgeted for the ongoing replacement of Information Technology (IT) equipment. This was true prior to the recession, and IT equipment funding unfortunately was an easier target for reduction when faced with the choice of eliminating jobs or services. However, it is essential that the City remain as current as fiscally possible in the Information Technology area, as modern technology is designed to enhance workflow and operations, thereby allowing us to leverage our employees' workday to the maximum. An example of this is the computers that are found in all Police cars and Fire apparatus that provide up-to-the-minute databases, communications tools, and other technology access. Since FY 2007, the City has used a General Fund contribution to the Information Technology Investment Fund for routine replacement of computers, servers/controllers, major software purchases and enhancements. The annual request for these types of purchases generally is close to $3 million, but our ability to fund these replacements has been limited to $500,000. I am proposing an increase in annual funding of $950,000, bringing the funding level to $1,450,000 for FY 2014. This is still short of what is needed annually for the regular replacement of IT equipment as it wears out or has become technologically obsolete, but it is an investment that we need to make now. As we grow more dependent on technology, this funding becomes even more critical.

To be able to fund the six expansion areas, the FY 2014 recommended budget reflects reductions in most other operational expenses, as well as the recommended rate and fee increases. In other words, those reductions are net of these necessary increases. There are few enhancements based on contractual circumstances or specific needs. As expected, in response to falling revenues, it was necessary to reduce service levels in some areas, as detailed below.

SERVICE IMPACTS

Reduction in Force, Redirected Staffing

I am recommending a net reduction of 18 positions in the General Fund for FY 2014, with a net reduction of seven other positions City-wide. We have cut a net total of 163 positions City-wide over the past five years, with this reduction representing a 6% decrease of our workforce. This net reduction would have been higher; however in FY 2014 the City will become the operator of the new Peninsula Regional Animal Shelter, with the addition of eleven (11) new positions in that operation. And of course, we must operate the new Denbigh Community Center. One position is being eliminated from the Historical Services Fund and twelve allotments from the Public Utilities (Waterworks) Fund. Two positions are moving from the General Fund to the Stormwater and Wastewater Funds, as their duties primarily support those operations, and new positions are being added to these Funds in support of the required work for the Regional Consent Order for sanitary sewer operations.

The net number of position reductions identified above does not represent the full number of reduced positions over the past years. Some of the positions that have been eliminated have been repurposed to support efforts to improve efficiencies and/or to enhance our efforts and citizen responsiveness in critical areas. Examples of these are the staffing of the

311 Customer Contact Center and Denbigh Community Center in FY 2013, or the new positions at the Peninsula Regional Animal Shelter.

With the City being a service organization, it is clear that the majority of our operating costs are invested in our employees as salaries and fringe benefits. For FY 2014 and consistent with past budget preparations, my approach again was to attempt to minimize any layoffs. With the scale of eliminated positions in the past, and fewer employees performing essentially the same services as a workforce equal to 10 years ago at the FY 2004 level, it is hard to find positions where the operational cost of a function is clearly no longer justifiable. It is only in those instances where I have recommended position eliminations. The number of actual recommended reduction-in-force positions is eight (8) full-time employees and thirteen (13) vacant positions. In addition, three (3) positions transferred to other operating funds, and six (6) positions will be added. Three (3) of the new positions were considered essential to operations and therefore created by the elimination of other departmental vacancies. The remaining three (3) positions were anticipated in the current fiscal year for the full staffing of the 311 Customer Contact Center. The net position change in the General Fund for FY 2014 is 18 fewer positions; the chart below details the proposed position changes.

General Fund Position Changes

Position Type	Filled	Vacant/ Transfer	New	Net Change
Front Line	-4	-7	4	-7
Management	0	-1	0	-1
Professional	-3	-6	2	-7
Support/Clerical	-1	-2	0	-3
Total	**-8**	**-16**	**6**	**-18**

Due to the partial hiring freeze that we have had in effect since the fall of 2009, we have been able to eliminate resulting vacant positions. The functions of these vacancies are no less important, and those duties have been added to the workload of remaining positions. The Attrition Credit that was first instituted in FY 2009 at $1 million is now almost $8.8 million City-wide, with 73% (or $6.4 million) in the General Fund alone for

FY 2014. (An Attrition Credit reduces a department's budget for salaries and fringe benefits based on an anticipated lag time between an employee termination and when a new employee is hired.) This budget was balanced due to these ongoing savings. As a reminder, the City has an established Reduction-In-Force (RIF) policy that allows for any employee who would lose their current position due to a reduction in force, to have the opportunity to apply for, and if qualified, be placed in vacant positions over other applicants. After five years of cutting positions, this continues to be the most difficult choice that is made when developing a proposed budget. It is my hope that most of the individuals affected by the RIF have the opportunity to find different employment with the City.

Service Reductions

Without the revenue generated by the proposed Real Estate Tax rate increase, noticeable and unacceptable service cuts would have been recommended in this budget. Reducing positions, consolidating efforts where possible, leveraging technology, and increasing some fees and taxes have been our strategies in the past, but we are to the point where these actions are either insufficient to cover the operating needs or where core services would be curtailed. As a result of the supplemental real estate tax revenue from the rate increase, there will be a minimum impact on service delivery to our citizens. Newport News continues to have an exceptional range of services, which is an important quality-of-life consideration for retaining current residents and attracting new businesses. In an effort to mitigate the level of the Real Estate Tax rate increase, there are some areas where reductions in service levels are recommended.

Parks, Recreation and Tourism functions will be impacted in two areas by this recommended budget. First, I am recommending that the City-maintained public pools be consolidated and Magruder Pool be closed. This facility is a badly aging pool that continues to leak water, which most likely has lead to the deteriorating piping and under-pool ground erosion, possibly resulting in causing other structural damage. There would have to be a major capital investment now in order to open and continue to operate. In addition, the Magruder Pool location is in part the site for the new Magruder Elementary School. With the Doris Miller pool less than one mile away, I am proposing increasing the Doris Miller facility operations to seven (7) days per week and hours opened from 40 to 55 hours per week. These additional hours will accommodate users from both pools, allow for longer hours of operation, and for special swim times/events. To compensate for the closing of the Magruder pool, the Doris Miller pool budgets would increase by $34,698 to accommodate more staff and operations (e.g., chemicals) in order to extend the hours. The net savings of closing Magruder pool is ($30,527) in addition to the current year savings in the spring start-up (repairs and renovations) costs needed to make that facility pass the annual Health Department inspection. By making the decision to close Magruder pool now, we avoid new expenses and assist NNPS in advancing the construction of the important new school.

There is also the elimination of one (1) full-time Marketing Coordinator position ($62,230) in the Historical Services Fund. The position is the coordinator of Historical Services website, social media and three (3) gift shops. The proposed elimination will cause these responsibilities to be reassigned to other staff members. While the position is in the Historical Services Fund, the reduction would come from the Nondepartmental annual contribution to that Fund.

In the Libraries and Information Services Department, I am recommending reducing operating expenses by ($206,000). This will occur by repurposing the West Avenue Branch ($133,600 in savings), and by the reduced personnel costs anticipated by centralizing and consolidating the computer lab training staff ($54,250).

The West Avenue Branch as a public circulation location is recommended to close in FY 2014. This Branch has been experiencing declining circulation and has been operating with reduced service hours since FY 2011. It is currently open on Mondays, Wednesdays, and Fridays. It is within two miles of the Pearl Bailey Branch and within five miles of the Main Street Branch. This closure will result in the elimination of two (2) full-time positions, a Supervising Librarian A position, a Senior Information Services Specialist position, as well as various operating expenses. The part-time staff will be moved to the Pearl Bailey Branch to absorb any additional service demands at that location. The library collection will be moved to the South Morrison outreach facility. The building itself is historical and needs to be maintained, including the Christopher Newport mural contained there. The best use of the space is to relocate the Technical Services (the library materials acquisition and cataloging functions) staff from lower level of the Grissom Library Branch. In the future, the Grissom Branch is anticipating a renovation/maintenance of the existing space. In anticipation of this, moving the Technical Services function to the closed the West Avenue

Library Branch allows for the best program flexibility within the Grissom Library Branch during renovation, as well as keeping the West Avenue Branch building maintained with daily operational use. As part of the West Avenue Branch closure, a book drop will be maintained at the site, to allow patrons to return books at the facility. The closure is expected to save ($133,603). As the building will be fully maintained, the City could choose to reopen the Library in the future should that be desirable.

To assist the City in meeting its Workforce Development goals and to enhance efficiencies, a decision was made to centralize the existing Libraries Computer Lab training staff from each individual branch to one location, the South Morrison facility. This will result in the elimination of one (1) Computer Lab Specialist position ($54,250), with the remaining two positions supporting the three branches (Grissom, Main Street, and Pearl Bailey), along with a new second computer lab for public use at the South Morrison facility. This consolidation is not expected to reduce any of the services or classes currently being offered at the branches, but allows for a more efficient and centralized coordination of services by computer lab training staff members.

Innovations and Efficiencies

I am recommending some changes that will affect specific departments and some overall City operations, with the potential for substantial savings and improved citizen responsiveness.

For the Fire Department in FY 2014, the department will create a pool of part-time medical providers to staff medical transport units during peak hours to provide a savings by reducing the amount of overtime used by the full-time EMS and first responders by ($90,040). This also enables these personnel to fill other shortages that may exist in daily staffing. The department will also reclassify three (3) Firefighter/ Medic positions to three (3) Staff Lieutenant positions to provide savings in the overtime staffing costs of ($36,644). This will also expand the pool of candidates for promotions, and give the added flexibility to adjust schedules and assign Officers to assist with other administrative tasks.

In support of our Strategic Sustainability efforts, the Public Works Department will contract services from an energy audit firm with the goal to find approximately $150,000 in energy savings City-wide.

There are two internal efficiencies that I am proposing, which will have only an effect on City central services operations. First is the consolidation of the Police and Central Warehouse functions during FY 2014. A plan is being formulated that will provide for the proper inventory and just-in-time stocking of essential and emergency items, and appropriate staffing in a shared space. Recognizing the uniqueness of each operation, both functions will be fully funded for the first six months of the new fiscal year, with the goal to be consolidated for the second half of FY 2014. This will ultimately eliminate one position from each department for a total savings of ($100,000). Additional cost savings will occur within the Police and Central Warehouse operations as part of this consolidation.

The second efficiency that I am recommending is to change the scope of work performed by the City's Print Shop to provide a more limited operation for basic, routine, or highly confidential products. All other print jobs will be contracted out to vendors. This focus shift results in the elimination of two Printer positions ($95,732).

OTHER OPERATING AREAS

Debt Service and Cash Capital

General Fund support for the City's Debt Service will be $36,450,390 in FY 2014. This figure includes payments for outstanding General Obligation Debt and a full-year expense for bonds issued in July 2011 and in September 2012. It also reflects the combined saving in debt service generated from three bond refunding of over $142 million that took place in calendar year 2012. The Recommended Budget assumes no new General Obligation bond issuance during FY 2014, with the anticipation that our current bond cash could be stretched until early winter 2014, which would be in fiscal year 2015. Even with the potential capital project of the magnitude of replacing an elementary school in the near future, through prudent cash flow management of bond proceeds we expect to be able to stretch our bond cash for more than 18 months from the issue date.

Cash Capital, a component of the City's adopted Capital Improvement Plan, is budgeted at $3,894,246 or $1 million more than the current fiscal year. The adopted FY 2014 – 2017 Capital Improvements Plan (CIP) anticipates using $6,220,000 in cash capital funding, with an additional $3,300,000 from the Special Projects Fund to satisfy our Capital Financing and Debt Management Policies requirement of 20% cash capital funding. If all Cash Capital and Special Reserve Funds are used for these projects, a total of $9.5 million will be funded, reaching a 27.6% level of cash capital funding. Cash Capital allows for current operating funds to be used to fund less expensive and more regular capital investments (e.g., roof and HVAC replacements, and capital equipment) to decrease reliance on bond cash for shorter term capital projects. By using $1 million of the additional revenue generated by the real estate tax increase, we are able to close the gap on the funding needed to support the extensive and necessary list of cash capital projects in the FY 2014 CIP.

Community Support and Regional Organizations

My recommended funding for the thirty-one (31) Community Support agencies that are supported by the City is basically equal to the current fiscal year at $2,244,989. Regional Organizations that the City is a member or participant of is $6,792,627, which is also level funding, maintaining the bus services that we currently have. The FY 2014 combined Community Support and Regional Organizations amount is proposed at $9,037,616. This represents an increase in funding of $480,490, or 5.6% from FY 2013.

For FY 2014, the goal in formulating the Community Support and Regional Organizations recommendation was to maintain level funding for organizations that provide services to our citizens. For a majority of the Community Support agencies, annual reductions have been imposed on them since FY 2010. Many of these organizations augment City functions, and by reducing them any further, we would stand the chance of losing services that we depend upon that are provided at a reduced cost.

For all Community Support agencies, funding will be equal to the FY 2013 level, which is essentially the FY 2012 amount, with one exception. Funding in the amount of $66,263 for the Virginia Arts Festival will be eliminated. Should this entity choose to program events in Newport News which we wish to support, my proposed Cultural Attractions Fund could be a potential source of funding.

Regional Organizational Agencies are those where most of the City's contributions are based on a contractual agreement on a per capita support level. The Hampton Roads Planning District Commission, recognizing the fiscal stress that its member localities are under, submitted a FY 2014 request that included a 5% reduction from the contractual agreement would have generated. No other Regional Agencies offered reductions voluntarily. I am recommending level funding in FY 2014 for

these agencies with three exceptions: removal of funding for one agency and increased funding for two organizations. I am recommending the elimination Hampton Roads Partnership in the amount of $14,450.
For the two transit agencies that support the Newport News citizen, I am recommending funding increases. For Williamsburg Area Transport Authority (WATA) that provides bus service between James City County and HRT's Lee Hall stop in Newport News, an additional $10,000 in funding is proposed to support the 13% increased in ridership since FY 2010.

In the past, HRT funding has been difficult to determine. At the outset of each year, HRT estimates its costs for the year and generates a budget for each of the participating localities. At year-end closing, HRT provides either a credit or an additional charge to each locality on a prorated basis based on the total cost of operations for the Agency as compared to the amount of the locality funding during the fiscal year. HRT requested a combined $5,751,843 from the City in FY 2014. This represented an increase of $551,203 over the currently estimated expense for FY 2013. This increase of 9.6% maintains the same level of service and routes that the City is currently engaged in, and includes anticipated savings from an efficiency study conducted by HRT in FY 2011 that resulted in some route changes beginning in January 2012. The majority of the increase is right-sizing our paratransit service hours for FY 2014 to be equal to what was actually used in FY 2012. Approximately $279,000 of the increase is associated with increasing the paratransit numbers used by 3,270 hours. To maintain the regular routes, the special events service we have now, and for higher HRT administrative costs, the increase is $272,000 in FY 2014.

At this point, I have recommended funding for HRT of $5,751,843 in FY 2014. However, it has become very clear that regardless of the efficiencies that we desire and the level of funding we provide, there is no assurance that we will avoid a costly year-end reconciliation expense from HRT for operating cost allocation from the other participating localities.

The final amount recommended in Community Support and Regional Agencies is a Contingency amount of $30,000. While not specifically designated, this would allow for funding during the fiscal year for agency support as designated by City Council or the City Manager, if deemed eligible by the City Attorney's Office.

There were nine (9) agencies that solicited support in the amount of $238,292 that are currently not funded by the City. Some of these requests were for the restoration of funds eliminated in prior operating budgets and some were new grant requests. I am not recommending any new initiatives in such a challenging budget year that would require reducing funding to existing agencies that continue to provide important ancillary services to our citizens. In addition, I am continuing to suspend the program that allows for eligible agencies to request reimbursement for Real Estate Tax or Personal Property Tax payments made in the preceding fiscal year. I cannot endorse further eroding our revenue base in the current budgetary environment.

RATES AND FEE INCREASES

This balanced budget has been achieved with practical, sustainable expenditure reductions and with tax rate and fee increases. In the past, a Real Estate Tax rate increase has been avoided by maximizing the stronger performing local revenues and real budget cuts. We are at the point with declining Real Estate Assessment values and a still-lumbering economic recovery that no options will generate the level of General Fund revenues required to sustain current service levels without changing the real estate tax rate. To recap, I am proposing raising the Real Estate Tax rate by twelve (12) cents, the Lodging Tax by 0.5% and instituting a flat $1 per day Lodging Tax, as well as raising the Amusement/Admission Tax from 7.5% to 10%. Combined, the net revenue generated will be $14 million, taking into consideration the revenue lost by the lower Real Estate assessments.

For the User Fund fees, there are increases driven by mandates, and therefore rate increases are unavoidable. In the Wastewater and Stormwater Management Funds, these rate increases are driven primarily by the impact of the Consent Order and other environmental regulations. As detailed in the recent presentation to City Council, our requirement to reduce or eliminate sanitary sewer overflows and reduce the flow of pollutants into our waterways will require prompt studies and investment in system improvements. As these mandates affect all localities in Hampton Roads, consideration is being given to creating a regional wastewater organization that would take over the management and operations of wastewater processes. This review is massive and highly intricate, as consideration of a multitude of aspects unique to each locality must be weighed and valued. For this reason, some of the rehabilitation work has been slowed until a decision on regionalization is made.

However, this study does not relieve us of our immediate obligations, nor does it remove us from a long term and very costly proposition, regardless of the results of this study. To address the Wastewater and Stormwater Funds needs, I am recommending that both rates be increased: on Wastewater from a rate of $2.79 per hundred cubic feet used to $3.21, and on Stormwater from $7.45 per ERU monthly to $8.00 monthly. In the Solid Waste Fund, the $0.50 per-week increase on the container rate is necessary to cover the cost of operations. These proposed rate changes are shown below:

SOLID WASTE USER FEE		Per Week		**Per Week**
	Container Size	(each)	**Container Size**	**(each)**
	Medium	$4.60	**Medium**	**$5.00**
	Standard	$5.75	**Standard**	**$6.25**
STORMWATER MANAGEMENT FEE				
Rate/Equivalent Residential Unit/Month	$7.45		**$8.00**	
Annual Rate per 1 ERU	$89.40		**$96.00**	
SEWER USER FEE				
Rate/100 cubic feet/month	$2.79		**$3.21**	

For Public Utilities, there continues to be a decrease in water demand consistent with other water utilities nationwide. Following an observed decrease in demand of 5.5% from FY 2011 to FY 2012, an additional decrease of 5% is now projected for the current fiscal year (FY 2013). A slightly lower additional reduction of 3% in customer demand is being forecasted for FY 2014. This observed demand trend prompted City Council in FY 2012 to begin to shift the rate structure to collect more revenue from fixed service charges and less from volumetric use. This approach is consistent with the cost structure of the utility as cost of operations is predominantly fixed and nearly independent of volume of water sold. With the planned "right-sizing" of the anticipated demand for FY 2014, the need to more aggressively adjust the fixed service charges to customers is necessary.

Therefore, I am also recommending that some Water fees be increased in FY 2014. The Water Rates themselves will be at the same level as FY 2013. Waterworks continues to reduce operating expenses where possible, but these savings do not make up for declining water consumption. The proposed rates are shown below:

WATER RATES

Water Consumption Rates per one hundred cubic feet (HCF):

Fee	FY 2013	FY 2014
Single-Family Residential Bimonthly		
R1 Low Usage Lifeline (0 to 4 HCF)	$3.08/HCF	**$3.08/HCF***
R2 Normal Use (Greater than 4 to 50 HCF)	$3.55/HCF	**$3.55/HCF***
R3 Conservation Tier (Greater than 50 HCF)	$7.10/HCF	$7.10/HCF
Industrial Monthly		
I1 Tier 1 (0 to 40,000 HCF)	$3.55/HCF	$3.55/HCF
I2 Tier 2 (Greater than 40,000 HCF)	$3.08/HCF	$3.08/HCF
General (All Other Consumption)		
G - All other usage	$3.55/HCF	$3.55/HCF

Please note, while the Rate per HCF is proposed not to change in FY 2014, the Low Usage Lifeline threshold will change from 6 HCF to 4 HCF

	FY 2013		FY 2014	
Meter Size (Inches)	Monthly Charge	Bi-Monthly Charge	**Monthly Charge**	**Bi-Monthly Charge**
5/8	$6.60	$8.70	**$14.70**	**$22.00**
3/4	$7.90	$10.90	**$17.60**	**$27.90**
1	$10.60	$15.50	**$23.50**	**$39.60**
1 1/2	$26.00	$47.00	**$38.00**	**$69.00**
2	$39.00	$72.00	**$57.00**	**$106.00**
3	$83.00	$160.00	**$122.00**	**$235.00**
4	$120.00	$235.00	**$176.00**	**$345.00**
6	$221.00	$437.00	**$324.00**	**$641.00**
8	$342.00	$679.00	**$502.00**	**$996.00**
10	$480.00	$956.00	**$704.00**	**$1,402.00**

The user fee increases are largely unavoidable, as they are driven primarily by regulatory requirements. I am confident that every effort had been made to reduce costs where possible, increase operational efficiencies, use reserves of the funds as appropriate, and yet there are no other options under the burden of these mandates except for recommending these increases. Below is a chart that shows the potential impact on an average homeowner of all the rate and fee changes that this recommended budget contains. Taking into account the average decline in real estate assessments in the upcoming year, the typical homeowner will still have lower Real Estate Tax burden than in FY 2008, while retaining the current service level that they enjoy.

This table is based on the values associated with a household of four and had an average 2013 real assessment of approximately $175,500. (This same median assessment valuation was $201,350 in FY 2009.)

FY 2014 - Impact on Typical Household	*Weekly Increase*	*Monthly Increase*	*Annual Increase*
Real Estate Tax	$3.23	$13.98	$167.78
Stormwater Fee	0.13	0.55	6.60
Solid Waste Fee	0.50	2.17	26.00
Sewer User Fee	0.53	2.31	27.72
Water Fees and Rates	1.70	7.36	88.26
Total Impact	**$6.08**	**$26.36**	**$316.36**

MOVING FORWARD

I believe this operating budget recommendation positions the City and our community for the future.

Over the next several years, the economic conditions that set the parameters of the City's fiscal environment are likely to be characterized by slow growth. Real estate values should stabilize, and cuts from the State should level off as the Commonwealth's income-tax-driven budget gradually improves. To be realistic, dynamic revenue increases from either real estate or State programs are unlikely. Local taxes should continue to grow modestly, but the effect on the full impact of the Federal sequestration and the broader decline of Federal spending, will no doubt have a dampening effect on any local recovery. While the future path the economy will take still remains unclear, current trends suggest that this community will largely be prepared to manage its fiscal challenges, meet its commitments, and take advantage of opportunities that arise.

Moving forward, we should continue to use our Strategic initiatives as guides for making judgments about where to invest our limited resources. This budget is fully consistent with these priorities and strengthens the community's ability to make further progress in the years ahead.

CONCLUSION

In summary, I have submitted a balanced budget with a minimum of service delivery reductions. The Recommended Budget includes necessary tax rate and fee increases, and additional reductions to achieve the level of City operations desired by our citizens and/or mandated by higher levels of government. This budget achieves the objectives of funding our pension and health care obligations, increasing funding to

Schools, funds limited new initiatives in the midst of declining revenue, and provides a salary adjustment for our valued employees. In order to lessen the impact of the rate and fee increases, I am recommending difficult but necessary sustainable reductions. These are all significant accomplishments, given the constraints that we face, and the reductions that we have endured over the past four years. This Recommended Budget maintains the City's hard-earned, well-deserved reputation for strong financial management as we hopefully emerge from the worst economic period since the 1930's.

My staff at all levels and I have worked very hard to develop a budget that is responsive to the current economic climate, and yet maintains essential core services for our citizens. I particularly want to acknowledge the staff of the Department of Budget and Evaluation for their diligence during this process.

While this memorandum highlights the budget in general, specific areas of interest will be detailed in Budget Position Papers, which will be delivered to you on or around April 5. All budget documents will be made available to the public on the City's web site and in all Newport News public libraries. We are also in the process of producing a NNTV program that will be the second in the series on the budget and will discuss key focal points of the FY 2014 Recommended Budget. It will be available to the public in the very near future.

I believe that this FY 2014 Recommended Operating Budget is responsive to our organizational and community needs and that I am proud to present for your consideration. I will work with you and the citizens of Newport News to finalize this budget through upcoming work sessions and public hearings. I thank you for your support.

Neil A. Morgan

NAM:LJC